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IN THE

# Supreme Court of the United States

October Term, 1959

PAUL E. KERN, JEROME PRINCE and CHARLOTTE HEINE,

*Petitioners,*

v.

THE COLUMBIA GAS SYSTEM, INC., *et al.*,

*Respondents.*

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

GEORGE ZOLOTAR,
521 Fifth Avenue,
New York 17, N. Y.

LEO T. WOLFORD,
501 South Second Street
Louisville 2, Ky.,
*Counsel for Petitioner, Paul E. Kern.*

EDWIN R. DENNEY,
210 Security Trust Building,
Lexington, Ky.,
*Counsel for Petitioners, Jerome Prince and Charlotte Heine.*

March, 1960

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*A.:* Page references to Petitioners' Appendix in the Court of Appeals.

*Alterations:* Alterations and Modifications to Plan of Reorganization dated February 25, 1958 as Amended, proposed on behalf of Kentucky Public Creditors.

*American:* American Fuel and Power Company, one of the Debtors.

*American Notes:* Five Year 7% Convertible Gold Notes, due July 1, 1934, of American Fuel and Power Company.

*American public creditors:* The public holders of $1,905,100 principal amount of the American Notes.

*American System:* The natural gas companies consisting of American Fuel and Power Company and its wholly-owned subsidiaries; Inland Gas Corporation; and Kentucky Fuel Gas Corporation.

*Appendix A, Appendix B, Appendix C:* Appendices to this petition.

*Chapter X:* Chapter X of the Bankruptcy Act, §§ 101-276, 11 U. S. C. §§ 501-676.

*Columbia:* The Columbia Gas System, Inc.

*Debtors:* Inland Gas Corporation, American Fuel and Power Company and Kentucky Fuel Gas Corporation.

*Inland:* Inland Gas Corporation, one of the Debtors.

*Inland Bonds:* First Mortgage 6½% Sinking Fund Gold Bonds, due February 1, 1938, of Inland Gas Corporation.

*Inland Debentures:* Second Mortgage Ten-Year 7% Sinking Fund Debentures, due February 1, 1938, of Inland Gas Corporation.

*Inland Trustee:* Ben A. Williamson, Jr., Trustee of Inland Gas Corporation.

*Kentucky:* Kentucky Fuel Gas Corporation, one of the Debtors.

*Kentucky Bonds:* First Mortgage 6½% Sinking Fund Gold Bonds, due June 1, 1942, of Kentucky Fuel Gas Corporation.

*Kentucky Debentures:* Ten-Year Convertible 6½% Sinking Fund Gold Debentures, due June 1, 1938, of Kentucky Fuel Gas Corporation.

*Kentucky public creditors:* The public holders of $2,778,600 principal amount of Kentucky bonds and debentures.

*Plan:* Plan of Reorganization proposed by the Trustees, dated February 25, 1958, as Amended.

*Post-Bankruptcy Interest;* Interest accruing after institution of equity receivership proceedings for each of the Debtors.

*Pre-Bankruptcy Interest:* Unpaid interest at date of institution of equity receivership proceedings for each of the Debtors.

*Public Creditors:* Public holders of (a) $1,905,100 principal amount of American Notes; (b) $2,236,600 principal amount of Kentucky Bonds; and (c) $542,000 principal amount of Kentucky Debentures, or any class of them.

*SEC:* United States Securities and Exchange Commission.

*System:* The natural gas companies in the American System consisting of American Fuel and Power Company and its wholly-owned subsidiaries; Inland Gas Corporation; and Kentucky Fuel Gas Corporation.

*Trustees:* Ben A. Williamson, Jr., Trustee of Inland Gas Corporation and of Kentucky Fuel Gas Corporation; and Clinton M. Harbison, Trustee of American Fuel and Power Company.

*Underwriters:* Underwriters of the new common stock to be issued under the Alterations.

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## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Sixth Circuit, entered in the above-entitled case on January 27, 1960.

### Opinions Below

The opinion of the Court of Appeals (per Judges Martin and Cecil) and the dissenting opinion of Judge Miller, printed in Appendix B, *infra*, pages 4c-13c and pages 13c-20c, are not yet officially reported. The oral opinion of the District Court (A. 66a-69a) * is not reported.

### Jurisdiction

The judgment of the Court of Appeals was entered on January 27, 1960 (Appendix B, *infra*, p. 20c). On February 23, 1960 the Court of Appeals stayed its mandate pending application for certiorari. The jurisdiction of this Court is invoked under 28 U. S. C. § 1254(1).

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* A Table of Abbreviations and References appears in the forepart of this petition, pages v, vi.

## Questions Presented

1. Whether a District Court supervising corporate reorganizations proceedings under Chapter X of the Bankruptcy Act may refuse to hear, prior to consummation of a confirmed plan, a proposed alteration, predicated on reliable and practical underwritings made possible by improved economic conditions and producing at least $3,500,000 more in cash than the confirmed plan, which provides cash payment in full of all prior claims and thereby enables the sole remaining class of public creditors to salvage on account of its unpaid claims the materially increased value of the residual assets.

2. Whether the general rule disallowing post-bankruptcy interest in insolvency proceedings is subject to the exception that interest accruing after the institution of the proceedings is payable to unsecured creditors out of surplus assets when the bankrupt or debtor proves "solvent", and whether this exception requires revision of the distribution under a confirmed but unconsummated plan, promulgated when the debtor was insolvent, so as (i) to prevent a windfall (over and above full satisfaction of its allowable claims against the "solvent" debtor) to a parent corporation claiming through the debtor's stockholders, and (ii) to make the sizeable surplus available, instead, to the only class of public creditors of the debtor whose claims for post-bankruptcy interest have not been paid.

## Statutes Involved

The pertinent provisions of Chapter X of the Bankruptcy Act (52 Stat. 883, 11 U. S. C. §§ 501 *et seq.*) are set forth in Appendix A, *infra*, pages 1c-3c.

## Statement

The many years during which these corporate reorganization proceedings have been pending have not been sterile years. They have been marked by significant op-

erational changes, vast economic improvements and considerable accumulations of unneeded cash. They have witnessed the periodic retirement of the claims of senior classes of public creditors through payments in cash. Approximately $15,000,000 of estate funds have been distributed over the years in satisfaction of such claims (together with full interest to the date of payment), leaving the Kentucky public creditors and Columbia as the only unpaid creditors of Inland. In substance, if not literally, these lengthy proceedings have nurtured a series of piecemeal plans (instead of a single comprehensive plan) crowned with the highest achievement attainable under the Bankruptcy Act: cash payment of claims in full. What still must be accomplished is a fair and equitable distribution of the residual valuable assets between Columbia, the adjudicated wrongdoer whose illegal and inequitable conduct seriously injured innocent public investors,[1] and

[1] As part of a scheme for gaining control of the System for the purpose of eliminating the threat of competition, Columbia acquired at saleable discounts substantial amounts of the debtors' debt securities, as well as stock and other interests. It promptly sought to wreck the debtors by throwing them into judicial proceedings, later supplanted by the present proceedings. The court below subsequently determined that Columbia's inequitable and unlawful conduct in accomplishing its scheme required that all of its claims against each of the debtors be subordinated to "the claims of all other creditors of every class" in the System. *Columbia Gas & Electric Corp.* v. *United States*, 151 F. 2d 461, 470; 153 F. 2d 101. This was the culmination of findings that Columbia "drew to itself the lifeblood of all the debtors and picked the flesh from the bones of these corporate entities," that its abhorrent and immoral scheme violated Federal antitrust laws and that "the result of its misconduct was to defraud the minority interests of the debtors". *In re American Fuel & Power Co.*, 122 F. 2d 223, 228, 229; see *In re Inland Gas Corp.*, 187 F. 2d at 815. To carry out the subordination effectively, the public holders of debt securities of American and Kentucky, companies owning substantially all of the stock of Inland, were held to be "creditors or quasi-creditors of Inland". *In re Inland Gas Corp.*, 187 F. 2d 813, 817. Columbia's claims against each of the debtors were thus subordinated to (a) the direct claims of the public creditors against their respective debtors, and (b) as against Inland's assets, to the claims of the public creditors of American and Kentucky.

the sole remaining creditor class of Columbia's victims: the public holders of Kentucky Bonds and Debentures.

The most recent Plan was promulgated on the basis of financial conditions prevailing as of December 31, 1957, when Inland was still insolvent (A. 4a, 9a). Appeals from the District Court's confirmation of the Plan, resulting in affirmance (262 F. 2d 510), were finally disposed of on April 27, 1959 (359 U. S. 979). Within a few days thereafter, on May 5, 1959, there emanated from responsible investment bankers, insurance companies and underwriters of the highest repute, who had never previously participated in these proceedings,[2] firm financial commitments producing for reorganization purposes some $3,500,000 more in cash than the Plan provides (A. 34a-54a, 57a). This increase meant that Inland, the only debtor with assets of value, was no longer insolvent. All senior public creditors had been paid in full with post-bankruptcy interest; there was now sufficient cash to pay in full the allowable claims of Columbia against Inland with post-bankruptcy interest on secured claims; and there was a considerable surplus sufficient not only to satisfy the principal amount of the claims of the Kentucky public creditors, the only other unpaid claimants against Inland, but also to accord them some participation for their large claim for post-bankruptcy interest.[3]

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[2] These were: KIDDER, PEABODY & CO., INCORPORATED—nationally-known investment bankers (A. 34a-35a); MASSACHUSETTS MUTUAL LIFE INSURANCE COMPANY and HOME LIFE INSURANCE COMPANY—well-known insurance companies (A. 36a-45a); EMPIRE TRUST COMPANY—New York City banking institution (A. 46a-48a); DEMPSEY & COMPANY and H. M. BYLLESBY AND COMPANY, INC.—Midwestern investment bankers and underwriters (A. 49a-54a).

[3] The claim of the Kentucky public creditors at August 31, 1959 amounted to $7,658,823, of which $2,376,012 represented unpaid principal and $5,282,811 represented unpaid interest. The principal of Columbia's claims against Inland amounted to $2,143,467 and the interest to August 31, 1959 on its secured claims aggregated $3,637,197, or a total of $5,780,664. This calculation does not include post-bankruptcy interest on Columbia's unsecured claim

Relying upon Sections 222 and 229 of Chapter X (11 U. S. C. §§ 622, 629), which expressly permit a plan to be altered or modified "before or after its confirmation" and prior to its "substantial consummation", and upon the well-recognized "solvency" exception to the general rule disallowing post-bankruptcy interest to unsecured creditors of insolvent debtors, petitioners presented their application to alter the Plan to take advantage of the newly-available financings and underwritings (A. 9a-14a). This was prior to the taking of any steps to consummate the Plan (A. 4a-7a, 57a-59a).

The Plan and the Alterations may be compared as follows:

1. Both provide for an internal reorganization; and both provide for a practically identical capitalization, consisting of $4,000,000 to $4,250,000 of institutional indebtedness and new common stock (A. 22a-23a).

2. The Plan limits the Kentucky public creditors to cash payment of their principal, approximately one-third of their total claim;[4] and allocates the entire residue to Columbia in the form of all of the new common stock of the reorganized company. The Alterations reverse the process. They provide for cash payment of the allowable claims of Columbia against Inland, including full post-bankruptcy interest on its secured claims; and allocate the residue for the benefit of Kentucky public creditors in the

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against Inland, which is subordinate to the unsecured claims of the Kentucky public creditors. The only other System claims of Columbia are $629,301 principal amount against American and $2,149,077 against Kentucky (all of which except $60,000 are unsecured); as American and Kentucky are stockholders of Inland, and Columbia's claims against those companies were subordinated, there can be no value for these claims until all creditors of Inland have been paid in full with interest. Throughout we use calculations to August 31, 1959.

[4] A minor amount of pre-bankruptcy interest is included, but all post-bankruptcy interest is excluded; in the case of the Kentucky Bonds, interim cash distributions have been deducted from principal.

form of the new common stock of the reorganized company (A. 25a-27a).

3. Translated into dollars the monetary differences are as follows:

*Columbia*—In lieu of new common stock judicially valued at $3,020,576 as of December 31, 1957 (A. 20a), Columbia would have received cash estimated at $5,780,664 (A. 26a).

*Kentucky Public Creditors*—In lieu of cash of $2,466,316 which they are to receive under the Plan, the Kentucky public creditors would have received at their option cash or new common stock of $3,265,160, plus the right to subscribe to $694,650 par value of new common stock (A. 17a, 26a, 28a-29a, 51a-52a).

Despite the Alterations' superior provisions for the two remaining classes of creditors, and although petitioners were supported by other representatives of Kentucky public creditors and by the Securities and Exchange Commission, the District Court summarily rejected the Alterations. Expert testimony tendered by petitioners to support the filing of the Alterations was refused and no other evidence was offered by any other party (A. 62a-63a). The District Judge ruled that " * * * There is no testimony necessary" (A. 63a) and made it plain that he was passing only on the "legal premises" of petitioners' applications (A. 77a-78a).

The District Judge's legal conclusion was that the Kentucky public creditors were barred from filing the Alterations because the Alterations gave them something on account of their unpaid claims for post-bankruptcy interest and that this rendered the Alterations incongruent with the Plan which restricted the Kentucky public creditors to principal only (A. 66a-68a, 77a-78a). He rejected arguments that the general rule disallowing post-bankruptcy interest, embodied in the Plan, was subject to the exception that such interest was payable when the debtor proved "solvent", as was now the case since all other public creditors

had been paid and the Alterations offered to pay Columbia's allowable claims in full with interest on its secured claims. He directed consummation of the Plan although it donates the surplus assets to Columbia, instead of the unpaid Kentucky public creditors, and thus attributes value to Inland's stock before the last of Inland's creditors have been paid in full with interest.

In affirming the District Judge, the majority in the court below relies principally on a restricted view of the purpose and meaning of the statutory provisions governing alterations of confirmed plans; it also extends a blanket, though largely unexplained, endorsement of the District Judge's legal conclusions as to the absence of any rights to post-bankruptcy interest on the part of the Kentucky public creditors. As to the latter point, the views of the District Judge were based on his interpretation of a 1957 opinion written by Judge Miller, then speaking for a divided court, in which Judge Martin concurred and from which Judge Simons dissented. See *In re Inland Gas Corp.*, 241 F. 2d 374, 381, 385. In that opinion, Judge Miller declared that while it is the general rule that "interest * * * ceases to accrue at the start of bankruptcy proceedings * * *" (a rule which he found to be applicable under the conditions of insolvency then existing), one of the well-recognized exceptions to the general rule is that "* * * If the alleged 'bankrupt' proves solvent, creditors receive post-bankruptcy interest before any surplus reverts to the debtor * * *". 241 F. 2d at 381. In the present case, Judge Miller (now disagreeing with Judge Martin[5]) finds that the debtor has "* * * become solvent within the meaning of that exception" and that the Kentucky public creditors, "* * * as the only class of creditors remaining * * *" are "* * * entitled to post-bankruptcy interest, insofar as remaining funds are

[5] As Judge Simons, who did not sit on the panel in the present case, voted in favor of awarding post-bankruptcy interest to the Kentucky public creditors regardless of insolvency (241 F. 2d 374), Judge Martin's view here that the "solvency" exception is not available to the public creditors clearly was a minority view in the 1957 opinions.

available to do so, before any surplus reverts to the debtor". Appendix B, *infra*, p. 19c.

In response to the majority's adoption of a narrow view of Section 222 to deny consideration of the merits of the Alterations, Judge Miller shows that the statutory language clearly calls for a broader reading. He also emphasizes that: the appellate court is not "* * * justified in closing our eyes to this available increase in asset value of the debtor corporation * * *"; the changes proposed by Petitioners in the plan are nothing "* * * more than necessary alterations permissible under the statute"; "* * * Columbia, a subordinated creditor, can have no reasonable valid objection to being paid in full in cash"; and the decision of the majority, permitting consummation of a Plan which denies post-bankruptcy interest to the public creditors but accords to Columbia substantially more than is needed to pay in full its allowable subordinated claims (including post-bankruptcy interest on its secured claims), is "* * * directly contrary to the ruling which this Court had previously made and consistently adhered to, that the rights of Columbia are completely and fully subordinated to the claims of all other creditors * * *". Appendix B, *infra*, pp. 14c, 16c, 17c, 18c.

## Reasons for Allowance of Writ

The case presents two questions of substantial importance in the administration of the Bankruptcy Act. The first is whether junior interests are entitled to a hearing on the merits of proposals, backed by practical offers of hard money from responsible financial institutions and underwriters, to pay the full amount of all prior claims in cash and thus improve the treatment they receive under a plan which has been confirmed but not consummated. The majority decision below, affirming a summary rejection of the proposal without a hearing, is in conflict with the decision of the Court of Appeals for the Second Circuit in *Knight* v. *Wertheim & Co.*, 158 F. 2d 838. It interprets

provisions essential to the proper functioning of Chapter X of the Bankruptcy Act in a manner contrary to their plain language and in apparent conflict with this Court's views; in particular, it frustrates the Congressional purpose, in adding Section 229 to Chapter X in 1952, to guard against a premature bar of post-confirmation changes often needed in reorganizations to maintain fair and equitable standards.

The second question relates to the so-called "solvency" or "surplus" exception to the general rule disallowing post-bankruptcy interest in insolvency proceedings. Although a surplus now exists within the meaning of the exception, after the full payment of all allowable claims of the debtor, the majority below adheres to an earlier determination in these proceedings, made when the debtor was insolvent, that the sole remaining class of public creditors is not entitled to post-bankruptcy interest. In declining to apply the "solvency" exception in the present financial circumstances, the majority decision is in conflict with the decision of this Court in *American Iron & Steel Mfg. Co.* v. *Seaboard Air Line Railway*, 233 U. S. 261, and the express recognition of the "solvency" exception in *City of New York* v. *Saper*, 336 U. S. 328. It is also in conflict with the decision of the Court of Appeals for the Fifth Circuit in *Johnson* v. *Norris*, 190 Fed. 459, and with the declarations on this subject of other federal courts.

Aspects of both questions have been the subject of law review comment.[6]

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[6] See Miller, *Status of Economic Interests in Proceedings Under Chapter X After Confirmation of the Reorganization Plan*, 24 N. Y. U. L. Rev. 707 (1949); Note, *Post-Confirmation Modifications in a Chapter X Reorganization Plan*, 61 Yale L. J. 264 (1952); 64 Harv. L. Rev. 1362 (1951); Note, *Allowance of Interest During Reorganization Proceedings*, 50 Yale L. J. 144 (1940); Note, *Post-Bankruptcy Interest in Chapter X Reorganizations*, 67 Yale L. J. 1131 (1958); Note, *Allowance of Post Petition Interest During Reorganization Proceedings Under Chapter X of the Bankruptcy Act*, 33 N. Y. U. L. Rev. 864 (1958); Laugharn, *Interest Payment After Bankruptcy and to Date of Payment Discussed*, 30

## I. The right of junior interests to alter unconsummated plans by paying off senior claims in cash.

### A. The conflict between Circuits.

In *Knight* v. *Wertheim & Co.*, 158 F. 2d 838, the Court of Appeals for the Second Circuit held that, despite the prior confirmation of a Chapter X plan, it was incumbent upon the district court to entertain an alteration proposed by stockholders which produced enough cash to pay off unpaid creditors who were to receive securities under the confirmed plan. That court rejected arguments, based on Section 224, that the order of confirmation was "binding" on all parties to the reorganization and not subject to changes materially altering the treatment of affected classes. Writing for the court, Judge Learned Hand stated (158 F. 2d at 842):

> "* * * The order of 'confirmation' is not conclusive, for § 222, 11 U. S. C. A. § 622, expressly provides that the plan may be 'altered or modified' after, as well as before, the plan has been confirmed. If an 'alteration' or a 'modification' does not 'materially and adversely affect the interests of creditors or stockholders', this may be done without further hearing; otherwise, if it does. * * *"

*Knight* also held that changes in the plan necessary to put in effect the underwriting proposals, upon which the stockholders' alterations were predicated, were not offensive to the statute.

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Ref. J. 72 (1956). One of the attorneys for one of the petitioners is a part-time lecturer on Corporate Reorganizations in the Graduate Division of the New York University School of Law, an affiliation to which some of the opposing counsel made reference on an earlier appeal.

See also Address by J. Arnold Pines, *Inland Gas Corporation—An Epic of Corporate Reorganization*, Rutgers University School of Business Administration, February 24, 1960, excerpts from which are set forth in Appendix C, *infra*, pp. 21c-25c.

The decision below is in direct conflict with *Knight*. Here, as in *Knight*, rapidly changing economic conditions made it possible to obtain an underwriting of the common stock of the reorganized company permitting Columbia's claims against Inland to be paid in cash instead of refunded in new shares. The common stock was thereby released for distribution to the public creditors or, if they preferred cash, to the underwriters who agreed to pay cash for the shares. As in the case of the debenture holders in *Knight*, Columbia was tendered full cash payment of its allowable claims, amounting to $5,780,000 and constituting the maximum to which it was entitled, and thus was no longer "affected" by the plan. The public creditors, on the other hand, were guaranteed considerably more than they were offered under the confirmed Plan whether they accepted stock or chose cash. Both classes of creditors were benefitted and neither was prejudiced. In all material respects, therefore, the alterations here and those in *Knight* were identical except for differences arising out of the financial details peculiar to each case. In addition, the alterations here were presented promptly after the confirmation order had become final and before any steps toward consummation had been taken.

Although this Court did not review the merits of the *Knight* decision, it had occasion to consider and recognize the importance of the issue. Because both lower courts in *Knight* had denied a stay of consummation of the confirmed plan, applications for a stay were made in vacation to Mr. Justice Reed. The stay was granted pending applications for certiorari. See *In re Equitable Office Bldg. Corp.*, 72 Sup. Ct. 1086 (In Chambers 1946); also printed in ROBERTSON AND KIRKHAM, JURISDICTION OF THE SUPREME COURT OF THE UNITED STATES 903-909 (2d ed. Wolfson & Kurland 1951). In granting the stay, Mr. Justice Reed declared (72 Sup. Ct. at 1090):

> "I think the stockholders are entitled to have determined the question of power in the district court to grant their petitions, and, if the power exists, the propriety of its exercise under the circum-

stances alleged or the facts that may be developed on a hearing. Widely shifting values make the issues of general importance in pending reorganizations under Chapter X * * *."

In apparent agreement with Mr. Justice Reed as to the importance of the question, and on the suggestion of the S. E. C., the Court took action on the petitions for certiorari which had the effect of keeping the stay alive until the court of appeals had reversed the district court.[7]

While the majority below professes not to be in disagreement with *Knight*, its attempted distinction rests on nothing more than an enumeration of insubstantial differences *in form* between the alterations here and those in *Knight*. In substance and in legal contemplation the cases are identical. In a subsequent opinion, Judge Learned Hand pointed out that in *Knight* the "* * * circumstances peremptorily * * *" demanded that the alteration be entertained "* * * for otherwise the bondholders would have gone off with a large equity, owing to the wholly unexpected appreciation of the property; a result which the whole history of foreclosure forbade. * * *" *Prudence-Bonds Corp.* v. *City Bank Farmers Trust Co.*, 186 F. 2d 525, 528. This is also the crux of the present case. Yet the majority below avoids all discussion of this basic point or of any other matter going to the substance of the alterations. As Judge Miller points out: "The majority opinion gives little, if any, consideration to the fact that the real reason for considering another amendment at the present time is

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[7] The parties obtaining the stay petitioned the Court for certiorari to review (1) the judgment of the district court prior to decision by the court of appeals, and (2) the order of the court of appeals denying a stay. At first, the Court denied so much of the petitions as requested direct review of the judgment of the district court, but held action on the remainder of the petitions in abeyance. *Dana* v. *Duncan*, 329 U. S. 784. It was not until the court of appeals had heard the cases and reversed the district court's rejection of the alterations that the Court denied new petitions to review the correctness of *Knight* and also the remainder of the earlier petitions relating to the stay no longer needed. *McGuire* v. *Equitable Office Building Corp.*, 331 U. S. 818; *Dana* v. *Duncan*, 331 U. S. 819.

that the proposed amended plan makes available for certain creditors approximately $3,500,000 more in cash for the payment of their claims than is available under the present plan. * * * Appendix B, *infra*, p. 14c. Summary rejection of the alterations, for " * * * reasons largely technical * * * " (*ibid.*), enables Columbia to escape with a windfall, over and above its allowable claims, and denies the surplus assets to unpaid public creditors willing to pay off Columbia in full.

**B. Allowance of significant post-confirmation changes is essential to the integrity of the reorganization process.**

1. If the statute did not permit post-confirmation changes of a material character, plans which unforeseen developments and financial improvements had rendered no longer fair or feasible would nevertheless have to be carried out in contravention of the equitable principles to which reorganization courts are dedicated. The court below, however, espouses principles which would have that precise effect upon the integrity of the reorganization process. It does this by placing its chief reliance on *Diversey Building Corporation* v. *Metropolitan Trust Company*, 141 F. 2d 65 (7 Cir.), and citing with approval a *dictum* [8] in that case as to the interpretation to be given to the alteration provisions in Section 77B(f), 11 U. S. C. § 207(f), the predecessor of 222 in Chapter X. As stated by the majority

[8] The actual decision in *Diversey* was that there was no "jurisdiction" in the District Court to entertain the proposed change. 141 F. 2d at 68. The proceeding in that case had been initiated under Section 77B, a plan had been confirmed *and consummated*, and a *final decree* closing the estate had been entered in 1935. Eight years later, in 1943, the debtor applied in the old proceeding (instead of instituting a new one under Chapter X) to have an amended plan considered because of its inability to carry out all of the terms of the old plan. On the facts, therefore, there is no conceivable resemblance between the problem here and in *Diversey*. In *Knight*, the *Diversey* decision was expressly considered and its holding was deemed not incompatible with a post-confirmation alteration permitting junior interests to pay off senior claims. 158 F. 2d at 842.

below, the alteration provisions were construed in *Diversey* "* * * * to mean that changes and modifications *after the plan is confirmed* refer to such changes as will better aid in carrying out the plan which has been finally confirmed, and does not mean such changes or modifications as will materially alter the property rights established by the decree of confirmation. * * * *" Appendix B, *infra*, p. 10c. In strong criticism of the *Diversey* interpretation, a leading text states: "* * * Such a construction finds no warrant in either § 222 or former § 77B(f) and would, if adopted, freeze the confirmation order into a rigid and unalterable mold." 6 COLLIER, BANKRUPTCY 3900 n. 13 (14th ed., Moore & Oglebay 1947).

*Diversey's* restricted view of permissible changes in a confirmed plan is based on an erroneous reading of the statute. Under Section 222, the alterations which may be proposed "after confirmation" include those which "materially and adversely affect the interests of creditors or stockholders". The statute also contains explicit instructions as to the procedure to be followed in the event that the alterations are materially adverse. The altered plan is subject to new hearings to consider whether it should be approved, to resubmission to the SEC for examination and report, to renewed voting by affected parties to accept and reject the plan and to new hearings to consider confirmation. If the altered plan has previously been accepted, Section 223 (11 U. S. C. § 623) specifies the mechanics to be used in ascertaining whether the changed plan is also acceptable to those who have already voted. These provisions, designed to safeguard investors whose interests are significantly changed by plan alterations, are completely inconsistent with the suggestion that the statute does not tolerate materially adverse alterations during the post-confirmation stage of unconsummated plans.

2. *Knight* specifically rejected the argument, based on *Diversey*, that post-confirmation changes should be restricted to mechanical details such as "errors, mistakes and omissions" 158 F. 2d 842. This Court also has attributed

to Section 222 the much broader meaning commanded by its plain language. In *Young* v. *Higbee*, 324 U. S. 204, the Court held that preferred stockholders who had appealed from an order confirming a plan, and had subsequently abandoned the appeal by selling their stock for a consideration substantially in excess of its value, were accountable in the Chapter X proceeding for the excess. The effect of the ruling was to increase the participation under the plan of the preferred stockholders as a class and, in response to the argument that the reorganization court could no longer accomplish this equitable result, the Court said (at 214):

> "* * * The District Court still has jurisdiction to exercise its powers under the Act both because of its express reservation and because of the provisions of § 222. * * *"

Section 222 was described as follows (n. 14):

> "This Section gives the judge power, under conditions applicable here, to alter and modify a reorganization plan even after confirmation."

The allocation in *Young* of additional assets to the preferred stockholders because it belonged to them "in equity and good conscience" was plainly not a mechanical change to aid in carrying out the confirmed plan. It was a significant change, comparable to what was proposed here to forestall forfeiture of a sizable surplus which in equity and good conscience belongs to the public creditors and not to Columbia. See also *United States* v. *Knight*, 336 U. S. 505, 508 n. 2.

In railroad reorganization cases under Section 77 (11 U. S. C. § 205), which contains no express provision for post-confirmation alterations, the Court has assumed *arguendo* "that both this Court upon appeal from an order of confirmation in bankruptcy, and the bankruptcy court itself, after its order of confirmation has been affirmed on review * * *, may take cognizance of subsequent changes in conditions and order a plan re-examined by the Inter-

state Commerce Commission. * * * " *Insurance Group* v. *Denver & Rio Grande Western R. Co.*, 329 U. S. 607, 611; see also *R. F. C.* v. *Denver & Rio Grande W. R. Co.*, 328 U. S. 495, 521-2. While the railroad reorganization cases are not decisive of the issue in this case,[9] note may be taken of the Court's indication in *Insurance Group* that re-examination would be supportable if a reasonable showing were made that under the plan senior creditors were receiving " * * * more in value than the face of their claims * * * " 329 U. S. at 618. Such a showing has been made here as to Columbia's excessive participation.

The need for the alterations thus seems self-evident and a plausible explanation for the devastating blow which public creditors are dealt by the decision below is difficult to find. Perhaps the majority was influenced by the fact—to which its opinion adverts—that one of the petitioners, Paul E. Kern, "was not an original investor in the Kentucky bonds and debentures * * * ". But neither was Columbia, which purchased its bonds and debentures at depressed prices after the Debtors had experienced financial difficulties, largely as a result of Columbia's unlawful effort to stifle the competition they were giving Columbia. See *In re American Fuel & Power Co.*, 122 F. 2d 223; *Columbia Gas & Electric Corp.* v. *United States*, 151 F. 2d 461; *In re Inland Gas Corp.*, 187 F. 2d 813. Columbia's purchases were made pursuant to a scheme to destroy the Debtors and injure their public security holders and it was Columbia, which improperly initiated the judicial proceedings to which the Debtors have since been subject. *Ibid.* As to Kern,

[9] In all such railroad reorganization cases considered on the merits—some of which were cited below by respondents—the Court was satisfied that the earnings or other factors urged by the excluded classes as warranting re-examination had been envisaged and considered by the I. C. C. in the valuation it reached. Here there is no similar attempt to reopen an issue of valuation previously adjudicated. The effort here is to take advantage of the higher values which responsible underwriters are now placing on the assets and supporting with cash proposals not previously available.

there was no bar to his purchases; on the contrary, it has been stressed that former holders of a debtor's securities would be seriously prejudiced if they could not dispose of their holdings in a free market during reorganization. To characterize Kern a "speculator"—though he has been an owner of Kentucky debt securities for some twenty-two years—and to allow this to play any part in reaching a decision prejudicial to public creditors as a class and beneficial to Columbia—an adjudicated wrongdoer—is extraordinary indeed. What the Court said in *Young* in a similar context seems especially appropriate (324 U. S. at 214):

> "Nor can we sustain the contention that relief should be denied on the allegations that Young's motive in bringing the proceeding is an unworthy one. His petition sought relief for the benefit of all the stockholders. The rights of these stockholders are not to be ignored because of some motive attributable to Young."

3. The majority below cites *Country Life Apartments v. Buckley*, 145 F. 2d 935, a decision of the Second Circuit which preceded *Knight*. In *Country Life*, the existing plan provided for a sale of the debtor's assets and a distribution of the proceeds among affected creditors. The proposed "modification", which was not based on any new financial developments since promulgation of the earlier plan and which could easily have been submitted as an alternate plan at earlier hearings, provided for an internal reorganization in which new securities would be issued in exchange for old claims. The modification, which the lower court had in any event found to be not fair and not feasible, was said to come too late under the circumstances existing in *Country Life*. That decision, however, was distinguished in *Knight* so as not to preclude post-confirmation changes necessary to put into effect a newly-available underwriting reflecting financial improvements occurring subsequent to preparation of the confirmed plan.

In distinguishing *Country Life*, Judge Learned Hand conceded in *Knight* that the alterations should be "to some

extent congruent with the plan" (158 F. 2d at 842). But he hastened to add: "* * * We cannot, however, agree that there are narrower or more definite limits than this. * * *" (*ibid.*); and in a later case he reiterated that the line of demarcation between permissible and non-permissible changes "is necessarily left at large". See *Prudence-Bonds Corp. v. City Bank Farmers Trust Co.*, 186 F. 2d at 528. It is quite evident that the statute embodies no restrictions and that these remarks were necessitated solely by the prior existence in that Circuit of *Country Life*. Realistically, *Knight* constituted a policy departure from *Country Life* in belated recognition of the need for greater flexibility to meet unanticipated developments. What the majority below derives from *Country Life* and the other opinions from which it quotes are labels such as "new" and "completely different" which it seeks to apply to the alterations here, in utter disregard of their substance or merits, for the purpose of justifying their summary rejection. Moreover, the terms are used in the context of the majority's expressed belief that only mechanical changes are permissible once confirmation has occurred, so that all material alterations, whether or not adverse,[10] are deemed to be "radical" departures from the confirmed plan. The fact is that if the alterations presented in this case constitute a "new" and "completely different" plan, this was no less true in *Knight*. The net result below is that an exercise in semantics is allowed to control the decision, the effect of which is to forfeit to a faithless parent the surplus assets which in equity belong to unpaid public creditors.

**C. Congress emphasized the importance of post-confirmation alterations in its 1952 amendments to the statute.**

The decision below subverts the Congressional policy, as expressed in 1952 amendments to Chapter X, to allow

[10] Judge Miller points out that the alterations in this case—which pay cash to Columbia instead of stock and give the stock to the Kentucky public creditors—are not *adverse* to the interests of either class. Appendix B, *infra*, p. 18c.

post-confirmation alterations of a materially adverse character. As construed in *Knight*, the statute permitted materially adverse alterations to be made at any time prior to entry of a final decree, even though the plan had already been consummated, subject only to a judicial discretion to refuse amendments which had been too long delayed. 158 F. 2d at 842, 843. In some quarters, there was still preference for confirmation, or a time reasonably close to confirmation, as a cut-off date and it was contended that the *Knight* construction created " * * * uncertainty as to the point in the reorganization proceeding at which rights vest under the plan sufficiently to make it equitable * * * to cut off further right to amend or modify the plan as to matters materially and adversely affecting the rights of creditors or stockholders by the ordinary procedure for the amendment of a plan under section 222". H. R. Rep. No. 424, 81st Cong., 1st Sess. 17 (1949). In view of the importance attached to the problem, it was brought to the attention of the Congress for a policy decision. H. R. 3111, introduced in the 81st Congress, proposed amendments to Chapter X requiring the judge to fix in the order of confirmation the date when the trustee would cease to operate the business and prohibiting materially adverse alterations after that date. These legislative proposals were opposed by the SEC as an undesirable infringement upon the flexibility afforded by Section 222 to take into account changing economic conditions which might require revision of earlier determinations that a plan was fair and feasible.

The objections of the SEC were subsequently composed by developing a new section, § 229 (11 U. S. C. § 629), specifying concrete tests for determining whether a plan has been "substantially consummated" and permitting materially adverse amendments until such consummation has occurred. See H. Rep. No. 2320, 82d Cong. 2d Sess. 2, 16-17 (1952). This proposal was enacted into law. 66 Stat. 431 (1952). See Appendix A, *infra*, p. 3.

The majority opinion below shows no recognition that in adopting this amendment Congress re-emphasized its

purpose, originally expressed in Section 222 (11 U. S. C. § 622) but now codified in unmistakable terms, to insure that the right to propose materially adverse alterations survives confirmation of the plan. The new section plainly wrote an end to any lingering contention, such as the majority below seeks to perpetuate, that the statute does not allow "such changes or modifications as will materially alter the property rights established by the decree of confirmation". Appendix B, *infra*, p. 10c. It also substituted a definitive statutory bar date—after which (but not before) no materially adverse alterations may be entertained—in lieu of the uncertainty of relying upon judicial discretion to decide whether the proposal should be refused consideration because of delay in presentation. And it rendered obsolete such prior decisions as *Diversey* and *Prudence-Bonds*—cited by the majority below—in both of which the alterations were presented many years after the plans had been completely consummated.

Conversely, the delay which occurred in these proceedings before the present plan was promulgated and *prior* to confirmation—so strongly stressed below—has no bearing on the timeliness of the proposed alterations. Judge Miller shows that the delay has been beneficial to parties in interest and points out that the court below heretofore "* * * consistently recognized that the equitable treatment of creditors under materially improved financial conditions fully justified additional delay in bringing the proceeding to a conclusion" and that there is "* * * no reason why we should now reject that prineiple if materially changed conditions again warrant a further delay." Appendix B, *infra*, pp. 13c, 14c. The delay has been especially advantageous to Columbia. Prior to 1957, the court below and Columbia accepted the fact that because of Columbia's subordination it would receive no participation in the assets and earlier plans omitted Columbia entirely. The alterations now offer Columbia $5,780,000 in cash.

The present delay, in any event, arises because of Columbia's unwillingness to accept this full cash payment

of its allowable claims. It has been Columbia's maneuver to refuse the payment and simultaneously to complain that the stock underwriting which would have produced the cash has lapsed with the passage of time. Similar tactics by the debenture holders in *Knight* received no encouragement from Mr. Justice Reed (72 Sup. Ct. at 1090) or Judge Learned Hand (158 F. 2d at 842). "* * * It is indeed true", said Judge Hand, "that the offer * * * has long since lapsed, and that at present there is no outstanding offer; but it does not follow that a new offer may not be made of enough cash to pay off the debentures. * * * "

The lower court's challenge to the general Congressional policy, and to the specific legislative purpose in Section 229 to codify the *Knight* holding that confirmation is not a bar to materially adverse changes, warrants review by the Court to resolve the issue.

**II. The change from "insolvency" to "solvency" during the pendency of a plan demands revisions to comply with fair and equitable standards.**

Inland's emergence from insolvency, as demonstrated by the new financing proposals made possible by economic improvements since the Plan was promulgated, brought into play rules of distribution demanding revision of the existing plan provisions. It has been held, as a general rule, that post-bankruptcy interest will not be allowed to unsecured creditors of an insolvent debtor; this general rule was applied to the Kentucky public creditors at a time when Inland was admittedly insolvent and unable to pay the principal of all of its outstanding claims. *In re Inland Gas Corporation*, 241 F. 2d 374, 381. As was true in the cited opinion, all statements of the general rule have usually been accompanied by the declaration that "There are two well-recognized exceptions to this general rule", the first of which is that "If the alleged 'bankrupt' proves solvent, creditors receive post-bankruptcy interest before any surplus reverts to the debtor * * * " 241 F. 2d at 381.

In *City of New York* v. *Saper*, 336 U. S. 328, the Court's last pronouncement on post-bankruptcy interest, the general rule ("a fundamental principle of the English bankruptcy system which we copied") was applied to tax claims. Mr. Justice Jackson noted, however, that in England the "solvency" or "surplus" exception had been recognized [11] and was one of the " * * * exceptions carried over into our system", citing *American Iron Co.* v. *Seaboard Air Line*, 233 U. S. 261, 267. In *Seaboard*, an equity receivership proceeding in which the assets were returned to the debtor upon its undertaking to discharge unpaid claims, it was argued that the creditor was not entitled to interest during the receivership. In ruling that interest was payable, the Court said (233 U. S. at 266):

> " * * * as a general rule, after property of an insolvent is in *custodia legis* interest thereafter accruing is not allowed on debts payable out of the fund realized by a sale of the property. But that is not because the claims had lost their interest-bearing quality during that period, but is a necessary and enforced rule of distribution, due to the fact that in case of receivership the assets are generally insufficient to pay debts in full. * * * in case funds are not sufficient to pay claims of equal dignity, the distribution is made only on the basis of the principal of the debt. But that rule did not prevent the running of interest during the Receivership; and if as a result of good fortune or good management, the estate proved sufficient to discharge the claims in full, interest as well as principal should be paid. * * * "[12]

Citing *Johnson* v. *Norris*, 190 Fed. 459 (5 Cir.), a leading bankruptcy case in this area, the Court declared

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[11] Citing *Bromley* v. *Goodere*, 1 Atk. 75; *Ex parte Mills*, 2 Ves. Jr. 295; and *Ex parte Clarke*, 4 Ves. Jr. 676. 336 U. S. at 330 n. 7. See also 2 *Blackstone, Commentaries* * 488.

[12] In *Ticonic National Bank* v. *Sprague*, 303 U. S. 406, 413, involving the rights of secured creditors in a national bank receivership, the Court also declared that " * * * the obligation to pay interest is not destroyed by the insolvency * * * ".

that the rule was the same in bankruptcy so "that creditors were entitled to interest accruing after adjudication" in the "rare instances where the assets ultimately proved sufficient for the purpose" (233 U. S. at 266-7). Since *Saper*, the "solvency" or "surplus" exception has either been recognized or applied in *Littleton* v. *Kincaid*, 179 F. 2d 848, 852 (4 Cir.); *United States* v. *Harrigton*, 269 F. 2d 719, 720, 722 (4 Cir.); *United States* v. *Bass*, 271 F. 2d 129, 130 (9 Cir.); *In re F. P. Newport Corp.*, 123 F. Supp. 95 (S. D. Cal.), appeal dismissed, 216 F. 2d 344 (9 Cir.); *Marcalus Manufacturing Co.* v. *United States*, 169 F. Supp. 821 (Ct. Cl.).

As the normal situation is one justifying the stoppage of interest at the initiation of the proceeding, the exception presupposes subsequent developments, whether through "good fortune or good management", which warrant alteration in the rule of distribution. In the context of corporate reorganizations, the improvement in financial conditions creating a surplus often occurs during the course of the proceedings and may appear after confirmation of a plan. Unless rights have vested in persons not parties to the proceedings, which under Chapter X can not occur earlier than "substantial consummation" (§ 229), the surplus assets must be allocated to those equitably entitled to them. Whether this is done through an alteration or modification complying with § 222, or by any other equitable method, seems immaterial since the power and duty of the reorganization court to give effect to the exception are undoubted.

The majority below fails to give vitality to the exception simply because it had occasion earlier, in circumstances of insolvency, to hold that the general rule was then applicable. Since the alterations tendered to Columbia full cash payment of $5,780,000 (of which the greater portion, $3,637,000, represents post-bankruptcy interest on secured claims), the consequence of the decision is to divert the surplus above this amount to Columbia even though the claims of public creditors for $5,200,000 of post-bankruptcy

interest remain completely unpaid. Columbia thereby not only participates to the extent of post-bankruptcy interest on its unsecured claim (even though under the law of the case this claim is subordinate to the claims of public creditors), but also on account of claims it holds against other companies in the System which, as stockholders of Inland, are entitled to no assets until all of Inland's creditors (including the public creditors) have been paid in full with interest. This allocation of the surplus is incompatible with the design of the "solvency" exception to guard against inequitable reversions to a debtor's stockholders and is in conflict with the applicable decisions of this Court and other courts of appeal.

Admittedly there exist *dicta* casting doubt on the availability of exceptions to the general rule disallowing post-bankruptcy interest. In *Sword Line v. Industrial Commissioner of New York*, 212 F. 2d 865, 869, Judge Clark, writing for a divided court, commented that "• • • the Supreme Court has not yet settled the extent and nature of these suggested exceptions • • • " and "• • • in pursuance of an overriding policy the Court may ultimately think it not desirable to allow any at all • • • ". Recently it has been questioned whether an exception allowing post-bankruptcy interest to a secured creditor when the proceeds of his security are ample for that purpose—frequently referred to in the cases as "the third exception"—should be recognized since Saper noted only two exceptions. *United States* v. *Harrington*, 269 F. 2d 719, 723.[13] The Ninth Circuit

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[13] The Referee's decision reviewed in *Harrington*, "disallowing United States tax claims for post-bankruptcy interest and penalties in which notices of lien were filed before bankruptcy", was printed in the Journal of the National Association of Referees in Bankruptcy [33 Ref. J. 12 (1959)], which subsequently commented that the publication "has resulted in bringing into focus *a distressing conflict of decisions and opinion as to what the law is which urgently requires resolution, either by an authoritative opinion of the United States Supreme Court or by the enactment of legislation by Congress.*" (emphasis added). 33 Ref. J. 34 (1959).

—which has ruled both against and for the third exception (Cf. *Beecher* v. *Leavenworth State Bank*, 192 F. 2d 10, 14, with *Palo Alto Mutual Savings & Loan Ass'n* v. *Williams*, 245 F. 2d 77)—recently stated that it would continue to recognize the third exception "until Congress or the Supreme Court declares otherwise". *United States* v. *Bass*, 271 F. 2d 129, 130-131. This issue is of importance here since both the Plan and the Alterations award in excess of $3,637,000 to Columbia as post-bankruptcy interest on secured claims on the assumption that the third exception is valid.

The exceptions to the post-bankruptcy interest rule, being of practical and recurring importance, are continuously occupying the attention of the lower federal courts. A definitive ruling by this Court on the availability and scope of the exceptions would be of far-reaching significance in the bankruptcy field.

## CONCLUSION

**For the foregoing reasons, this petition for a writ of certiorari should be granted.**

Respectfully submitted,

GEORGE ZOLOTAR,
521 Fifth Avenue,
New York 17, N. Y.

LEO T. WOLFORD,
501 South Second Street,
Louisville 2, Ky.,
*Counsel for Petitioner,*
*Paul E. Kern.*

EDWIN R. DENNEY,
210 Security Trust Building,
Lexington, Ky.,
*Counsel for Petitioners,*
*Jerome Prince and*
*Charlotte Heine.*

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## APPENDIX A

The following provisions of Chapter X of the Bankruptcy Act (52 Stat. 883, 11 U. S. C. §§ 501 *et seq.*) are pertinent to the questions presented by this petition.

SECTION 222 (11 U. S. C. § 622). A plan may be altered or modified, with the approval of the judge, after its submission for acceptance and before or after its confirmation if, in the opinion of the judge, the alteration or modification does not materially and adversely affect the interests of creditors or stockholders. If the judge finds that the proposed alteration or modification, filed with his approval, does materially and adversely affect the interests of creditors or stockholders, he shall fix a hearing for the consideration, and a subsequent time for the acceptance or rejection, of such alteration or modification. The requirements in regard to notice of hearing, to submission to the Securities and Exchange Commission, to acceptance, to filing and hearing of objections to confirmation and to the confirmation, as prescribed in article VII of this chapter in regard to the plan proposed to be altered or modified, shall be complied with.

SECTION 223 (11 U. S. C. § 623). Any creditor or stockholder who has previously accepted the plan proposed to be altered or modified and who does not file a written rejection of the proposed alteration or modification within the time fixed by the judge, shall be deemed to have accepted the alteration or modification and the plan so altered or modified unless the previous acceptance provides otherwise.

SECTION 224 (11 U. S. C. § 624).

Upon confirmation of a plan—

(1) the plan and its provisions shall be binding upon the debtor, upon every other corporation issuing securities or acquiring property under the plan, and upon all creditors

and stockholders, whether or not such creditors and stockholders are affected by the plan or have accepted it or have filed proofs of their claims or interests and whether or not their claims or interests have been scheduled or allowed or are allowable;

(2) the debtor and every other corporation organized or to be organized for the purpose of carrying out the plan shall comply with the provisions of the plan and with all orders of the court relative thereto and shall take all action necessary to carry out the plan, including, in the case of a public-utility corporation, the procuring of authorization, approval, or consent of each commission having regulatory jurisdiction over the debtor or such other corporation;

(3) if the judge shall so direct, there shall be deposited and distributed, in such manner as the judge may direct, the moneys for all payments which by the provisions of the plan or under this chapter are required to be made in cash; and

(4) distribution shall be made, in accordance with the provisions of the plan, to creditors and stockholders (a) proofs of whose claims or stock have been filed prior to the date fixed by the judge and are allowed, or (b) if not so filed, whose claims or stock have been listed by the trustee or scheduled by the debtor in possession and are not contingent, unliquidated or disputed.

* * *

SECTION 226 (11 U. S. C. § 626). The property dealt with by the plan, when transferred by the trustee to the debtor or other corporation or corporations provided for by the plan, or when transferred by the debtor in possession to such other corporation or corporations, or when retained by the debtor in possession, as the case may be, shall be free and clear of all claims and interests of the debtor, creditors, and stockholders, except such claims and interests as may otherwise be provided for in the plan or in the order

confirming the plan or in the order directing or authorizing the transfer or retention of such property.

* * *

SECTION 229 (11 U. S. C. § 629).

a. A plan shall be deemed to have been substantially consummated if, insofar as applicable, each of the following events has occurred:

(1) transfer, sale or other disposition of all or substantially all of the property dealt with by the plan pursuant to the provisions of the plan;

(2) assumption of operation of the business and management of all or substantially all of the property dealt with by the plan by the debtor or by the corporation used for the purpose of carrying out the plan; and

(3) commencement of the distribution to creditors and stockholders, affected by the plan, of the cash and securities specified in the plan as provided for in section 224 of this Act.

b. Upon notice to the trustee, the debtor, the Securities and Exchange Commission and such other persons as the judge may designate, the trustee, the debtor in possession, the corporation to which the assets of the debtor are to be transferred under the plan, or any other party in interest may apply to the judge for an order declaring the plan to have been substantially consummated under the provisions of subdivision a of this section.

c. When a plan has been substantially consummated as defined in subdivision a of this section, or an order has been entered under subdivision b of this section, the plan may not thereafter be altered or modified if the proposed alteration or modification materially and adversely affects the participation provided for any class of creditors or stockholders by the plan.

# APPENDIX B

## Opinions and Order of Court of Appeals

In the Matters of:

INLAND GAS CORPORATION,
KENTUCKY FUEL GAS CORPORATION,
AMERICAN FUEL & POWER COMPANY,

*Debtors.*

Appeal from the United States District Court for the Eastern District of Kentucky.

Nos. 13,911; 13,955

Decided January 27, 1960.

Before: MARTIN, MILLER and CECIL, Circuit Judges.

MARTIN, Circuit Judge. We would need go to fiction rather than to the case books to find an appropriate parallel to this prolonged litigation. See *Jarndyce* v. *Jarndyce*, reported in "Bleak House" by Charles Dickens. The controvery presented by the present appeals evolves from an equity receivership instituted in late 1930, followed by proceedings under section 77(b) of the Bankruptcy Act and finally by corporate reorganization proceedings under *Chapter X* of the Bankruptcy Act. The two separate appeals which bring the case to us again at this late date are from an order entered by the United States District Court confirming a plan of reorganization.

*Appendix B—Majority Opinion of Court of Appeals*

For an understanding of the history and background of the case in all phases, we refer to our previous decisions, as follows: *In re Inland Gas Corporation et al.* [*Columbia Gas* v. *Lockhart et al.*] (1937), 91 F. (2d) 113 (C. A. 6); *In re Inland Gas Corporation, Piney Oil & Gas,* and *Hamilton Gas Co.* (1939), 102 F. (2d) 131 (C. A. 6); *In re American Fuel & Power Co.* (1941), 122 F. (2d) 223 (C. A. 6); *Columbia Gas & Electric Corporation* v. *United States* (1945), 151 F. (2d) 461 (C. A. 6); *Columbia Gas & Electric Corporation* v. *United States* (1946), 153 F. (2d) 101 (C. A. 6); *In re Inland Gas Corporation* (1951), 187 F. (2d) 813 (C. A. 6); *In re Inland Gas Corporation* (1953), 208 F. (2d) 13 (C. A. 6); *In re Inland Gas Corporation* (1954), 211 F. (2) 381 (C. A. 6); *In re Inland Gas Corporation* (1954), 217 F. (2d) 207 (C. A. 6); *In re Inland Gas Corporation* (1957), 241 F. (2d) 374 (C. A. 6); *In re Inland Gas Corporation* (1959), 262 F. (2d) 510 (C. A. 6). The first two above listed opinions have no relevancy now.

Our opinion reported at 151 F. (2d) 461 (1945) discloses the historical background; and our last two opinions, entitled "In re Inland Gas Corporation", reported respectively at 241 F. (2d) 374 (1957) and at 262 F. (2d) 510 (1959) relate to, and we think control, the issues directly presented by the present appeals.

At the conclusion of our latest opinion (decided January 15, 1959), reported at 262 F. (2d) 510, certiorari denied April 27, 1959, 359 U. S. 979, we stated that United States District Judge Ford had appropriately applied our adjudication set out in 241 F. (2d) 374, with respect to post-bankruptcy interest and to all other issues before him. The appeals were accordingly dismissed and the judgment of the district court, confirming the plan of reorganization, was affirmed. In that portion of our opinion written by Judge Miller, in which the writer concurred, we held directly that post-bankruptcy interest should not be allowed

the public holders of bonds and debentures of the Kentucky Gas and Fuel Corporation.

In proceedings in the United States District Court following remand, Paul Kern filed what he called "Alterations and Modifications" of the Plan of Reorganization which had been confirmed. Kern was not an original investor in the Kentucky bonds and debentures but began buying them in 1941 and continued to increase his holdings until he owned thirty-four percent of the outstanding issue of bonds and debentures. Throughout these lengthy proceedings, this speculator has filed six appeals from the district court's orders and judgments. At the conclusion of the hearing, the district judge announced his denial and rejection of the proposed petition for alterations and modifications and granted the petition of the Inland Gas Corporation for an order consummating the plan. The present appeals are from that order, which was entered on June 1, 1959.

We are of opinion that the United States District Court correctly and faithfully followed the mandate of this court. A comparison of the proposed alterations and modifications of the Plan of Reorganization with the Plan, which we have heretofore affirmed, clearly reveals that the alterations and modifications under consideration are not merely such, but in totality constitute an altogether new and different proposed plan of reorganization.

At the outset, the so-termed "Alterations and Modifications" entirely eliminate Article I, which discloses the directions of the district court to the Trustee as to the method of drawing the plan and states the principles upon which the reorganization is grounded. Indeed, nothing appears to be left of the confirmed Plan, except the partial description of the reorganization and history of the debtor. Many changes demonstrate that an entirely new plan is presented under the guise of "Alterations and

Modifications." Notation should be made of the following important changes:

(1) The alteration suggested by Kern would forbid the Trustee of Inland Gas Corporation from paying claims and reorganization expenses and fees, and would impel the transfer of all physical properties and cash to the reorganized corporation which would assume the obligation of making such payments;

(2) Article *V* of the confirmed plan has eliminated therefrom the reorganization value of $10,538,800 upon which the plan is predicated;

(3) The classification of the creditors as set forth in Article *VI* is so changed that the public creditors of Kentucky, rather than those of Columbia, would receive all stock of the reorganized corporation;

(4) The capitalization of the reorganized corporation is completely changed from 500,000 authorized shares of common stock and a short-term unsecured bank loan not to exceed $4,000,000 to a wholly different capital structure. The proposed complex capital structure consists of $2,530,000 of Series "A" five-and-one-half percent bonds, due October 1, 1971; $470,000 of Series "B" five-and-one-half percent convertible bonds, due October 1, 1971; a $1,250,000 Series "C" five percent first mortgage note, due October 1, 1962; and new stock of the reorganized corporation to be issued in the amount of $4,765,160 par value.

The three above-listed series of new bonds and the mortgage note would be secured by a first-mortgage on all the debtor's properties and, presumably, would be purchased by the insurance companies and the banks named in the so-called "Alterations". New stock of the par value $3,265,160 would be issued to public holders of Kentucky bonds and debentures. There would be offered

for sale on subscription rights to public holders of Kentucky bonds and debentures $694,650 par value of the new stock and $805,350 par value of that stock would presumably be sold to underwriters Dempsey & Company and Byllesby & Company who proposed, subject to specified conditions, to purchase at par all the new common stock which Kentucky creditors receive and desire to sell and all the new stock which Kentucky creditors would be entitled to purchase under the right to subscribe but did not desire to purchase;

(5) The proceeds from the sale of bonds and new stock, together with the cash balances of the Trustee, would be used to pay reorganization fees and other expenses and certain priority claims; to pay the American Fuel & Power Company notes with post-bankruptcy interest; to pay the secured claims of Columbia against Inland Gas Corporation, with post-bankruptcy interest; and to pay the unsecured claims of Columbia against Inland Gas Corporation without post-bankruptcy interest;

(6) Finally, the so-called "Alterations and Modifications" provide further that two insurance companies and a banking institution would supply the debt financing for which Kidder, Peabody and Company would be paid a fee of $45,000 for services. All the financing proposals, however, were made subject to contingencies. For example, the Home Life Insurance Company proposal letter states that the proposed financing by Kidder, Peabody and Company is in principle satisfactory to it, but that any binding commitment on its part would be subject to execution of a purchase agreement and indenture satisfactory to it and to its counsel. Moreover, the commitment of Dempsey & Company and Byllesby & Company to purchase at par all stock of the reorganized corporation which the public holders of Kentucky securities desired to sell or for which

they refused to subscribe is hedged with a time limitation of August 31, 1959, which has already expired.

The statute with which the appellants contend the district court failed to comply is section 222 of the Bankruptcy Act [11 U. S. C. A. 622], 52 Stat. 898: "A plan may be altered or modified, *with the approval of the judge*, after its submission for acceptance and before or after its confirmation if, *in the opinion of the judge*, the alteration or modification does not materially and adversely affect the interests of creditors or stockholders. If the judge finds that the proposed alteration or modification, *filed with his approval*, does materially and adversely affect the interests of creditors or stockholders, he shall fix a hearing for the consideration, and a subsequent time for the acceptance or rejection, of such alteration or modification. The requirements in regard to notice of hearing, to submission to the Securities and Exchange Commission, to acceptance, to filing and hearing of objections to confirmation and to the confirmation, as prescribed in Article [subchapter] *VII* of this chapter in regard to the plan proposed to be altered or modified, shall be complied with." [Italics added.]

Judge Ford stated that, had he sustained the position assumed by appellants and permitted the filing of their alterations or modifications, we would be "starting fresh, turning around and going back on another theory." We think the district judge did not abuse the discretion expressly granted him by the statute; but, on the contrary, we consider that he used sound common-sense, practical judgment in declining to permit an altogether new plan to be submitted, under the guise of alterations and modifications, in lieu of a sound plan already confirmed by him and approved by this appellate court, with certiorari denied by the Supreme Court of the United States.

In *Diversey Building Corporation* v. *Metropolitan Trust Co.*, 141 F. (2d) 65 (C. A. 7), the United States Court of

Appeals for the Seventh Circuit affirmed the district court, stating its belief to be that the Congress did not intend that a debtor corporation should be permitted to ask for a radical change of a plan of reorganization after the plan had been confirmed and was being executed under the supervision of the court. The subsection of the statute providing that changes and modifications may be proposed before or after the consummation of a plan of reorganization must be construed, the court asserted, with other pertinent subsections in order to understand the congressional intent. The subsection was interpreted to mean that changes and modifications *after the plan is confirmed* refer to such changes as will better aid in carrying out the plan which has been finally confirmed, and does not mean such changes or modifications as will materially alter the property rights established by the decree of confirmation. In no event, the court added, should any change be made without the consent of the court. The fact that the *Diversey* case was decided under section 77 (b) of the Bankruptcy Act does not affect applicability of its principles to the situation confronting us here.

*Country Life Apartments* v. *Buckley*, 145 F. (2d) 935 937 (C. A. 2), was a case of reorganization under Chapter X. There, the district court found that, at a confirmation hearing, the proposed amendments constituted a new plan and, for that reason, the court refused to permit such amendments to be filed. This judgment was affirmed on appeal. Judge Clark said: "Appellants' proposals filed by way of objections, however, differed so greatly from the trustee's plan that they could not possibly be treated as a mere modification. * * * Upon ascertaining this fact, the District Court was not required to listen to further arguments on the merits of the proposals, and hence committed no error in denying appellants further opportunity to be heard."

*Knight* v. *Wertheim*, 158 F. (2d) 838 (C. A. 2), is regarded by appellants as strong authority in their behalf. We do not agree with their argument for, in that case, Judge Learned Hand said that the proposed changes were not so radical as to fall within the ambit of the court's previous decision in the *Country Life Apartments* v. *Buckley* case. Comparison of the facts of the *Knight* case with those in this litigation will show the cases to be plainly differentiable.

Moreover, in *Prudence Bonds Corporation* v. *City Bank Farmers Trust Co.*, 186 F. (2d) 525, 528 (C. A. 2), Judge Hand impressively said: "* * * the Court may never under the guise of 'alteration' or 'modification' substitute an entirely new 'plan' in place of the original: although what is a line between a substitute and an 'alteration' or a 'modification' is necessarily left at large. * * * The question is one of discretion, though of a discretion which should be sparingly exercised, * * * unless the circumstances peremptorily demand it. * * * We cannot deny that the view which we now take may lead to abuse; it is often exceedingly difficult for a bankruptcy court to resist the importunities, usually unopposed, of those who wish to keep the 'revived debtor' indefinitely beneath its aegis; and our review of a discretion, which we may think to have been unwisely exercised, is not a very effective remedy. We can do no more than declare, for whatever weight it may have, that we deem the long delay which so often occurs between the order of 'confirmation' and the 'final order' a major abuse, and that a judge who superintends such a proceeding should feel himself charged with an affirmative duty to insist upon its early conclusion."

The contrast of the simple alteration approved in *Knight* v. *Wertheim*, *supra*, with the alterations and modifications proposed here is most striking. It would seem that any careful analysis of the plan which has been confirmed with the result reached should the alterations and

modifications of Kern be adopted clearly demonstrates that his offering constitutes actually a completely new and altogether different plan.

The confirmed plan embraces a statement of principles derived from directives of the district court and the decisions of that court denying post-bankruptcy interest to the public creditors of Kentucky Fuel Gas Corporation, while the proposed alterations eliminate those principles and award post-bankruptcy interest to the public creditors of that corporation. The plan is based upon a judicially determined valuation, while the alteration is not predicated upon any definitive valuation of Inland.

The plan calls for a simple capitalization of common stock and an unsecured bank loan: the alteration provides for a complicated capitalization of common stock and the issuance of three series of bonds and a mortgage note, all secured by a first mortgage on all the properties of the reorganized corporation. Under the confirmed plan, the capitalization of the reorganized corporation is assured by an unequivocal offer from a lender, while the finances proposed by the alterations and modifications is subject to several contingencies; and the underwriting offer to purchase stock of the reorganized corporation has already expired by prescribed time limitation. The plan provides for payment in cash of the principal amount of the claims of Kentucky creditors and the issuance of stock to Columbia: the alteration would require the payment of certain claims of Columbia in cash and the issuance to public creditors of Kentucky of stock for their claims. The plan calls for payment of claims and reorganization fees and expenses by the Trustee for Inland Gas Corporation, while the alteration proposes that these be paid by the reorganized corporation.

District Judge Ford aptly stated that section 222 authorizes modification, but does not authorize "stopping in the middle of a stream and starting a new plan with all

of its problems afresh." We think that he wisely said, also, that the two plans "are not kin in any respect in their major problems", being incongruous rather than congruous.

The appellees are correct in their assertion that the proposed "alterations and modifications" constitute an attempt to relitigate matters previously decided by this court and that the district judge did not abuse his discretion in denying them consideration.

In concluding what we hope will be our last words concerning this protracted litigation, we cannot refrain from commending the able, experienced and conscientious district judge, Honorable H. Church Ford, for his patient consideration throughout these many years of the trying and often complicated issues which have been presented to him for determination. We think that he has displayed wisdom in bringing this reorganization case, at "long last", to a successful conclusion, and deserves to rest upon his hard-earned laurels.

The judgment of the district court from which the appeals have been taken is affirmed.

MILLER, Circuit Judge, dissenting. I fully realize the prolonged period of time during which this reorganization has been in litigation and the sincere desire of those interested in it that it be brought to a conclusion. But, as the numerous appeals to this Court, referred to in the majority opinion, will show, the operation of the debtor corporation by the Trustee has been most successful over such period of years, with the most unusual result that successive delays have been necessary in order that proposed plans of reorganization could be amended or a new plan submitted so as to properly reflect for the benefit of creditors the materially improving financial and economic condition of the debtor under the management of the Trustee. Our previous treatment of this proceeding clearly shows that we have consistently recognized that the equitable

treatment of creditors under materially improved financial conditions fully justified additional delay in bringing the proceeding to a conclusion. It is against this background that we must consider the present appeals. I see no reason why we should now reject that principle if materially changed conditions again warrant a further delay.

The majority opinion gives little, if any, consideration to the fact that the real reason for considering another amendment at the present time is that the proposed amended Plan makes available for certain creditors approximately $3,500,000.00 more in cash for the payment of their claims than is available under the present plan. The proper and equitable distribution of this additional money is not provided for by the present Plan. Courts of bankruptcy are essentially courts of equity, and their proceedings inherently proceedings in equity. *Local Loan Co.* v. *Hunt*, 292 U. S. 234, 240. I do not believe that, based on reasons largely technical and on the fact that this reorganization has lasted for an unusually long time, we are justified in closing our eyes to this available increase in asset value of the debtor corporation, and in failing to allocate it among the creditors in some orderly and equitable manner.

The present situation is the result of the following developments. The plan which has been approved and confirmed, but not consummated, was proposed in February, 1958, on the basis of the financial conditions prevailing as of December 31, 1957. Subsequent to confirmation by this Court on January 15, 1959 (262 F. (2) 510) and denial of certiorari by the Supreme Court on April 27, 1959 (359 U. S. 979), responsible bankers and underwriters interested in reorganizing the debtor made commitments for debt financings and stock underwritings aggregating more than $9,000,000.00, the effect of which was to produce for reorganization purposes approximately $3,500,000.00 more in cash than is provided by the present Plan. These com-

mitments recognized and gave effect to a materially improved financial condition of the debtor corporation. It is true that this original commitment was subject to a time limitation of August 31, 1959. But, by a written letter of August 28, 1959, the date of October 31, 1959, was substituted for August 31, 1959, together with the statement that it was realized that further extensions might be necessary and it was the present intention, assuming no substantial change in general market conditions, to make any necessary extensions, although there was no commitment to do so. The proposed changes in the Plan give effect to this increased value of the assets of the debtor corporation.

For our present purposes it is sufficient to briefly summarize the difference between the treatment of creditors under the present Plan and the proposed treatment under the amended Plan in view of the increased asset value of the debtor corporation. Both the present Plan and the proposed amended Plan deal mainly with the rights and priorities of three classes of creditors, (1) American Fuel public creditors, (2) Kentucky Fuel public creditors, and (3) Columbia Gas. Both Plans provide for the payment in full in cash of the American public creditors in the approximate amount of $4,900,000.00, and, by agreement of the parties, these creditors have been paid. The issue involved is accordingly the treatment to be received by, and the allocation of assets between Kentucky public creditors and Columbia Gas. This Court has heretofore adjudicated the priorities between these creditors. The claim of Columbia Gas is subordinated to the claims of all other creditors. *Columbia Gas & Electric Corp.* v. *United States*, 151 F. (2) 461, C. A. 6th, modification denied, 153 F. (2) 101, C. A. 6th, cert. denied, 329 U. S. 737; *In re Inland Gas Corporation*, 241 F. (2) 374, 381-382, C. A. 6th. After the payment of the principal of the claims of Kentucky

public creditors, but without post-bankruptcy interest, Columbia is entitled to the payment of its claim, without post-bankruptcy interest on the unsecured portion thereof. *In re Inland Gas Corporation,* supra, 241 F. (2) 374, 382, C. A. 6th. This is now the law of the case.

The present Plan was based upon this law of the case. After payment of the principal of the claims of Kentucky public creditors in the amount of $2,466,316.00, the Plan allocates to Columbia all of the new common stock of the reorganized company, valued at $3,021,576.00, which is less than the principal amount of its claim with interest on the secured portion thereof, totaling $5,780,664.00. If this valuation had remained constant, the Plan would be fair and equitable.

But, the new financing commitments of 1959 recognized materially increased value of the common stock of the reorganized company, with the probable result that Columbia would receive through the common stock allocated to it more than $5,780,664.00, which is the total amount of its subordinated claim, while Kentucky public creditors, to which Columbia is subordinated, would only receive the principal of their claims without post-bankruptcy interest. This is directly contrary to the ruling which this Court had previously made and consistently adhered to, that the rights of Columbia are completely and fully subordinated to the claims of all other creditors (151 F. (2) 461; 153 F. (2) 101; 241 F. (2) 374, 381-382). Considering what this Court said in 151 F. (2) 461 about the conduct of Columbia in causing the financial collapse of the debtor corporation, I am unable to see how, at the present time, we can judicially approve the consummation of a plan which, in effect, will pay post-bankruptcy interest in part on the unsecured claim of Columbia and at the same time deny any post-bankruptcy interest on the claims of the Kentucky public creditors unless such result is now required by the applicable statutory provisions.

The proposed alterations prevent this result. The additional cash now available will be used to pay off in full in cash the total claim of Columbia in the amount of $5,780,664.00. Certainly, Columbia, a subordinated creditor, can have no reasonable valid objection to being paid in full in cash. The Kentucky public creditors will receive in lieu of the cash payment of $2,466,316.00 provided by the present Plan, new common stock of the par value of $3,265,160.00, plus the right to subscribe to $694,650.00 par value of new common stock. The underwriting commitment makes it possible for any Kentucky public creditor who prefers cash to sell the stock issued to him at its par value to the underwriters.

It will thus be seen that the proposed amended Plan will not only pay Columbia in full and at the same time keep it in its subordinated position to Kentucky public creditors, but will result in substantial increased payments to the Kentucky public creditors over what they would receive under the present Plan. This appears to me to be the proper equitable result and one which should be made effective unless we are barred from doing so by the applicable statutory provisions.

There is no legal bar to the alteration of the Plan at the present time, even though it has been confirmed. *Sec. 222 of the Bankruptcy Act, Sec. 622, Title 11, U. S. Code* provides that a plan may be altered or modified, with the approval of the judge, after its confirmation "if, in the opinion of the judge, the alteration or modification does not materially and adversely affect the interests of creditors or stockholders." The majority opinion points out numerous differences between the present Plan and the proposed amended Plan, taking the position that the proposed changes constitute more than an alteration or modification. But, the statutory test is not the difference in form, but whether the alteration materially and adversely affects the interests of creditors or stockholders.

*Appendix B—Dissenting Opinion*

The essential difference between the two Plans is that the present Plan gives the available cash to Kentucky public creditors and the stock of the new company to Columbia, while the proposed amended Plan pays cash to Columbia instead of stock and gives the stock to Kentucky public creditors instead of cash. Clearly, this does not materially and *adversely* affect the interests of creditors, as such interests are now defined by the law of the case. Its effect is a more equitable distribution of the available assets. Changes in the proposed corporate setup to make this more equitable distribution effective are, of course, necessary, but I do not regard such formal changes as being more than a necessary alteration of the present Plan in order to give the stock to Kentucky public creditors instead of to Columbia. Nor, do the proposed changes, as hereinafter pointed out, depart from the law of the case. On the contrary, in the light of present developments, the present Plan no longer follows the law of the case and changes are necessary to carry out those rulings. Accordingly, I do not regard the proposed changes as anything more than necessary alterations permissible under the statute. Any legal bar to its adoption, if any exists, would come from *Sec. 229 of the Bankruptcy Act, Sec. 629, Title 11, U. S. Code*, which provides that when a plan has been substantially consummated, as defined in that section, it may not thereafter be altered or modified so as to adversely affect the participation provided for any class of creditors or stockholders by the plan. The present Plan has not been substantially consummated as therein defined.

The record indicates that the District Judge refused to consider or discuss the merits of the proposed changes, but made the order rejecting them and ordering consummation of the present Plan because he was of the opinion that the changes were predicated solely on an asserted right on the part of the public holders of Kentucky bonds

and debentures to post-bankruptcy interest, and that such asserted right had already been adjudicated adversely to said public holders of Kentucky securities on two prior occasions by this Court. No hearing was held on the merits of the proposed changes. I construe the ruling as one of law holding that the proposed changes were not legally entitled to consideration, rather than an exercise of discretion in deciding whether the merits of the proposed changes were such as to receive his approval, which was necessary under the statute.

Considering it as a legal question, I am of the opinion that the ruling was incorrect. As pointed out hereinabove, this Court held in *In re Inland Gas Corporation*, supra, 241 F. (2) 374, 381-382, C. A. 6th, that Kentucky public creditors were not entitled to post-bankruptcy interest. No doubt, the District Judge had reference to that opinion. The proposed changes pay to Kentucky public creditors a portion (but not all) of post-bankruptcy interest on their claims. The reason for the ruling in 241 F. (2) 374, 381-382, was that it was the well established general rule that creditors in bankruptcy are not entitled to post-bankruptcy interest on unsecured claims, and the Kentucky public creditors, under the facts then existing, did not come within any of the three recognized exceptions to the rule. One of the recognized exceptions referred to in the opinion is that if the alleged "bankrupt" proves solvent, creditors receive post-bankruptcy interest before any surplus reverts to the debtor. At the time when the proposed changes were offered, the debtor had become solvent within the meaning of that exception. American Fuel creditors were being paid in full, and under the proposed changes Columbia would be paid in full, leaving Kentucky public creditors as the only class of creditors remaining. They are, accordingly, entitled to post-bankruptcy interest, insofar as remaining funds are available to do so, before any surplus reverts to the debtor. *American Iron &*

*Steel Manufacturing Co.* v. *Seaboard Air Line Railway*, 233 U. S. 261, 266; *New York* v. *Saper*, 336 U. S. 328, note 7, page 330; *Littleton* v. *Kincaid*, 179 F. (2) 848, 852, C. A. 4th; *In re F. P. Newport Corp., Limited*, 123 F. Supp. 95 99, S. D. Cal., appeal dismissed, 216 F. (2) 344, C. A. 9th; *Marcalus Manufacturing Co.* v. *United States*, 169 F. Supp. 821, Ct. Cls.

It may be that upon a hearing and discussion of the proposed changes, their merit may or may not be as strong as they now appear in the absence of a hearing and a critical analysis thereof. But, the proposed changes appear to me on their face to have sufficient merit to entitle the proponents thereof to a hearing and consideration of them on their merits. I think it was error to reject them without such a hearing.

I would reverse the judgment and remand the case for a hearing and a consideration of the proposed changes on their merits in accordance with the views expressed herein.

**Judgment**

No. 13,911

(Filed January 27, 1960)

Appeal from the United States District Court for the Eastern District of Kentucky.

This cause came on to be heard on the transcript of the record from the United States District Court for the Eastern District of Kentucky, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be and the same is hereby affirmed.

# APPENDIX C

EXCERPTS FROM ADDRESS BY J. ARNOLD PINES, CHIEF FINANCIAL ANALYST, DIVISION OF CORPORATE REGULATION, SECURITIES AND EXCHANGE COMMISSION

*Inland Gas Corporation—An Epic of Corporate Reorganization*

Rutgers University School of Business Administration
February 24, 1960*

* * *

"The value of the Inland estate continued to grow during the proceedings. Although Inland's earning power had initially been insufficient to pay the interest charges on its heavy debt structure, the operations of the company, beginning in the late 1930's, aided by favorable economic conditions, generated sufficient cash, which as I have indicated, was distributed to public creditors of the system.

* * *

"A new reorganization plan was filed by the Trustees in February 1958. It was predicated on a new system valuation of $11,030,000, and provided for a bank borrowing and payment in full of principal and interest on the publicly-held American Fuel Gold Notes (which payment has since been made in the amount of $4,905,632.50);[1] payment of the principal only on the publicly-held Kentucky Fuel bonds and debentures; and distribution to Columbia, in

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* Copies of the address contain the following note:

"The Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any private publication by any of its employees. The views expressed herein are those of the author and do not necessarily reflect the views of the Commission or the author's colleagues upon the staff of the Commission."

[1] Footnotes are omitted.

recognition of its claims, of all the equity in Inland, as reorganized, represented by the entire issue of a new class of common stock. The aggregate payment to the Kentucky Fuel bondholders and debenture holders would thus amount to $2,466,316—a figure which is based on treating the bulk of a prior cash distribution as a payment of principal rather than interest, and which is less than one-third of their aggregate claim to principal and interest as of August 31, 1959, of $7,658,823. As against the proposed distribution to the Kentucky Fuel public creditors, Columbia would receive 100% of the equity having a value, based on the foregoing over-all valuation, of about $3,021,000. This would exceed Columbia's claims against Inland for principal, and the excess would necessarily represent a payment on Columbia's claims against Inland for interest.

* * *

"Prior to consummation of the Trustees' plan, the appellant bondholders of Kentucky Fuel proposed certain alterations and modifications of the plan. They reflected an estimated valuation of the system's assets, as of approximately August 31, 1959, of some $14,638,000, and were supported by purchase commitments from institutional investors and underwriters. In addition to providing for full payment of principal and interest on the publicly-held American Fuel Gold Notes from funds on hand and to be raised by the sale of long-term debt securities to institutional investors, they provided for payment to Columbia of $5,780,537 in cash, representing the principal plus interest on its secured claims against Inland plus the principal only of its unsecured claims against Inland, and for issuance to the Kentucky Fuel public creditors of new common stock having an aggregate par value of $3,265,160, or about $800,000 in excess of the amount they would receive under the Trustees' plan. However, the Kentucky Fuel public creditors would have the option to receive cash equal to the par value of the stock proposed to be issued to them.

In addition, they would receive the right to subscribe to $694,650 par value of new common stock for cash.

"The bondholders' proposals were opposed by the Trustees and by Columbia. Since Columbia would supposedly receive only $3,021,000 in equity value under the Trustees' plan on the basis of the Trustees' valuation, one must ask why Columbia should resist proposals which would yield it $5,780,000 in cash. Can it be that Columbia does not really value the system's assets at the amount urged by the Trustees and accepted by the courts, but rather at some larger amount, perhaps approximating the value embodied in the bondholders' proposals? We must remember that institutional investors and underwriters are not prone to throw money away, and therefore they would hardly be likely to commit themselves to purchase the securities provided for in the bondholders' proposals unless they were convinced as to the value of the underlying assets. If we apply this higher value to the distributions proposed under the Trustees' plan, the allocation to Columbia would be worth approximately $6,447,000, as compared with the figure of $3,021,000 based on the Trustees' valuation. It would also exceed the $5,780,000 cash payment proposed to be made to Columbia under the bondholders' proposals.

* * *

"I suggest the following points as meriting your consideration:

* * *

"2. I think the court also correctly applied the doctrine of subordination in cutting across corporate lines to give the public creditors of the system a participation ahead of Columbia's debt claims. But I think it did not do so in excluding from participation the small public minority stock interest in Inland. I believe it was unfortunate that the court thereafter applied strict legal rules in disallowing post-bankruptcy interest to so-called unsecured creditors

injured by the controlling stockholder, Columbia, while at the same time allowing such interest to other creditors secured by the same kind of asset—Inland stock—underlying the unsecured claims. The irony of this disparate treatment is that, because the Inland estate increased in value far beyond expectation, the residual equity to be distributed to Columbia under the Trustees' plan is so large that it exceeds not only the principal of its secured and unsecured claims against Inland but also the interest thereon to boot. The later holdings of the court thus largely dissipated its earlier holdings on subordination.

"3. Valuation of an enterprise represents, in the final analysis, the application of unbiased and informed judgment to a mass of financial, operating, and statistical data. It is most important that the person making the valuation keep himself fully informed as to the state of the art of the particular industry of which the enterprise is a constituent part, as well as of important changes which have taken place in the nature of business of the enterprise itself. In the instant proceedings, the valuation submitted on behalf of the Trustees' plan was more than $3,500,000 less than the amount at which sophisticated institutional investors and underwriters, only one year later, agreed to purchase the enterprise. This difference is particularly unusual since it must be borne in mind that a very substantial part of the system's assets are comprised of net current assets, and therefore the difference is one which must be measured solely in terms of the physical assets. It raises a very serious question as to the soundness of the analysis of the Trustees' expert.

* * *

"4. The general principle that justice delayed is justice denied is ordinarily a sound one. In the instant reorganization, however, we have seen that many security holders have benefited from the extended proceedings.

*Appendix C—Excerpts From Address by J. Arnold Pines*

Thus, had Inland been reorganized at an early date, probably the only ones who would have participated in the reorganized company would have been the public holders of the first mortgage bonds and debentures of Inland, with the latter class being paid less than its full claim. There would have been no participation to the public creditors of American Fuel and Kentucky Fuel. As the proceedings continued over the years, and as Inland began to prosper, the enhancement in the value of the estate was of such magnitude as to permit cash payments of some $14,315,000 to the system's public creditors, leaving to be resolved the controversy as to the relative distributions between the public creditors of Kentucky Fuel and Columbia. In any event, while the proceedings appear to have lasted an inordinately long time, I believe the delay has conferred an overriding benefit on the public creditors as well as Columbia."